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Remarks of  
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Federal Energy Regulatory Commission

**"For Issues Critical To The Energy Future,  
Read Past The Headlines"**

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I.

Good morning. Thank you for once again inviting me to address the Energy Council and CLEER. The legislatures of the large gas and oil producing states like yours always have a keen and continuing interest in the state of energy economy. Your attentiveness will pay off during this highly transforming and dynamic phase of the market's development. I am naturally pleased to give you a FERC report card every year or so and to offer some guidance on what can be

expected from our special corner of the federal policymaking establishment. I hope to do a little of that today. We have had perhaps the most productive and exciting year in the Commission's history since I spoke to you last March. My colleague, Shelton Cannon, will walk you through the specifics of our historic electric restructuring order, Order No. 2000. By opening and reorganizing the market for bulk power, it offers vast business potential for the entire energy industry, not to mention billions of dollars in consumer benefits. That is only part of our story, however. We have also reengineered our organization, streamlined many of its processes, and taken major steps in the area of natural gas and hydroelectric policy.

Unlike last March, when you and I were discussing policy in an environment of \$10-per-barrel oil, energy

is suddenly topical. The currently volatile global oil market, higher prices at the pump, and tightening gas and oil deliverability have refocused the country on the issue of energy, where we get it, and how we use it. There are clear reasons to be bullish on gas and oil prices. Yet, it is equally clear that consumers and their representatives are concerned and feel vulnerable. On Saturday, the Washington Post observed that renewed agitation on the Hill to reduce gas taxes and recent exchanges between the Presidential candidates on that very subject "were signs of how energy policy has returned to the center of the political debate after years on the back burner." Well, hello from the back burner.

It is safe to say that in the energy industry as on Wall Street, never has such change and trauma been

associated with such success and prosperity. We live in transformative and thus uncertain times. However, I can only regard the renewed awareness of energy issues as a healthy development in itself, provided we as a Nation continue working on sound answers to our long-term energy needs without simply settling for the quick fix.

Now that our issues are on the front burner or the front page because the run-up in gasoline prices have been taken as signs of a policy vacuum, I feel obliged to emphasize that substantial progress is being made in key areas of energy policy. However, continued efforts will be necessary to sustain this historic and prolonged economic recovery. In pursuing them, we must ensure that neither the industry, nor energy consumers, nor national security, nor the environment are

short-changed as we move into the vastly different commercial environment of the 21st Century.

## II.

You and I know that energy policy is a complex matter, for which any panacea is suspect. Producer and consumer interests often diverge. State and federal perspectives often vary, especially on regulatory matters. The impact of energy development on the environment and on jobs is felt in a hundred different ways. But, I think it is safe to say that any reasonable policy must have both supply and demand components. In both areas, we have challenges and I believe we are meeting them.

The pressing issues of the day (i.e., gasoline and heating oil prices) have refocused us on the supply

side. While there is always more to be done to mitigate our vulnerability to oil price volatility, the achievements of recent years are notable. Clearly, the "new economy" is more energy efficient and less dependent on oil-based manufacturing than was the old economy. Even with such efficiency, demand for petroleum products is projected to increase. The industry and the economy were aided by the lifting of the ban on export of Alaska North Slope crude oil, opening the National Petroleum Reserve-Alaska (NPR) to exploration and development, deep water royalty relief, research and development programs, and incentives for onshore production from marginal wells. They have all contributed to a more sustainable energy economy and the energy security of American consumers.

Even the FERC is working to ensure a better future from the supply side. It has proposed a more competitive and fairly regulated gas and oil transportation system on the Outer Continental Shelf. It is changing course to ensure the availability of section 29 tax credits for gas production from tight formations, to help small business and to preserve oil and gas infrastructure. And, it has adopted policies that will help promote the expansion of the interstate natural gas pipeline network in a prompt but responsible way. The work we have done to relicense hydroelectric projects and promote electricity competition is part of the supply-side story as well.

A 30 or 35 Tcf natural gas market in the U.S. is no longer a pipe dream. The North American gas delivery network is highly integrated and increasingly interoperable. The FERC is confident that the openness

of the "grid" is playing a key role in developing and delivering new supply resources. The deployment of new technologies like distributed generation and fuel cells will enhance the industry's prospects, the availability of environmentally-sound alternatives, and the welfare of consumers. We also plan for the future by developing production technologies and renewable energy resources that may not yet be competitive. One can hope we are approaching consensus on the long-run value of that work.

The demand side of the energy security equation is equally important. The possibility of \$2 gasoline this summer is at least a reminder that conservation and efficiency must remain a key portion of our overall strategy. While we have made enormous strides in this area since the 1973 Oil Embargo, I fear we may be falling off the wagon. Of course, demand-side

management is not to be feared by conventional energy producers. Predictions of large increases in electricity and natural gas demand in the decade ahead should be predicated, not on an acceptance of profligacy, but on the prospect of price stability, clean energy, and a lean economy. Fuel diversity and adequacy, good markets, and a sensitivity to the environment will remain the secret to our success overall.

### III.

From a FERC perspective (which does not include the world of international oil and gas diplomacy), a progressive domestic energy policy can be summarized in one word: competition. It has taken 15 years and a succession of Commission rulemaking initiatives to develop an open and competitive interstate pipeline network. Gas producers today play a key supply role

but on a much bigger stage. The market is bigger, more competitive, and more diverse than ever before and, with that, come some tough competitive challenges.

The Commission's most recent work, Order No. 637, builds on eight years of success under Order No. 636, which "unbundled" pipeline services and led to a truly competitive market for interstate capacity. Order No. 637 fine-tunes the transportation market in several ways. For example, it removes price caps on short-term capacity release transactions. I expect that this will lead to what so many regulated industries found so valuable in the past; that is, a freer secondary or resale market that invites more entities to buy and sell pipeline capacity, increases efficient utilization of facilities, and moderates the price that can be asked for capacity under conditions of high demand and constrained supply.

We think that this initiative, coupled with seasonal rates and improvements in pipeline operating practices (e.g., flexible delivery points, balancing penalties, discouraging operational flow orders) will create greater transactional liquidity and more competition. To ensure that it does, the Commission will obtain and make available better information about capacity availability and price, enabling shippers to make more informed decisions.

Measures such as Order No. 637 move the interstate pipeline network in the direction of territory occupied by other less regulated or unregulated network enterprises. What we have accomplished with all segments of the gas industry, while still a work in process, is a sustainable market structure. Together with promoting competition within that market and developing adequate sources of supply, a sustainable

market structure should be among the fundamental objectives of any energy policy.

#### IV.

Of course, building competitive domestic energy markets is, in my view, an even more critical task during this period of profound industry changes. We are witnessing dramatic corporate consolidation based on the drive to attain scale and manage risk; convergence of the natural gas and electric industries, either formally or as a matter of mutual interest; a major earning shift from regulated to unregulated activities; and a renewed imperative to provide customer service and maintain reliability.

Industry and its regulators must accommodate these changes and reinvent the energy economy, even while

e-commerce obliterates previous commercial and operational boundaries, even as Wall Street romances the dot-com's with returns that are often extravagant, and even though energy industries continue to work within a patchwork of regulatory rules and inconsistencies among multiple jurisdictions. The North American electric and gas industries still remain more decentralized than banking or telecommunications. But there is growing agreement that competitive markets will take the industry in another direction.

The future of electric restructuring is of special importance to the states and especially to any constituents you have in the natural gas business. Electric generation is, after all, where most of the next increment of natural gas consumption will come from. And, as if that were not enough, the corporate

consolidation of gas and electric firms is accelerating and the competitive contest among gas, electric, and telecom providers for access to residential markets is intensifying.

That really brings me to the basic points I wish to make with you today. The restructuring of electricity markets, and retail gas markets as well, is occurring much too slowly. This is not a front page story ... yet. But the cost of this procrastination to consumers, the economy, and energy providers could be significant. True, market-defining, market-empowering federal legislation again appears unlikely this year. That scarcely absolves any company that wants to succeed, or any agency that wants to be responsible, of its obligation to address the needs of emerging competitive energy markets.

No longer should anyone ask why this transformation is happening or even what will happen. The salient question is, why is this taking so long? Restructuring is a label that conceals a host of discrete issues and points of view, to be sure. Yet, they seem to boil down to two critical issues: the development of competitive and efficient markets for power, and a suddenly serious accompanying problem -- the future of the Nation's legendary service reliability as commercial relationships in the industry change.

The FERC has made a historic effort to promote bulk power competition by trying to create new institutions that will alleviate pricing and other barriers to broad regional power markets -- so-called regional transmission organizations (RTOs). Out of practical necessity and the ambiguities of the Federal Power Act, however, the Commission is relying on persuasion and

collaboration and incentives to achieve RTOs on a voluntary basis within the next two years. It remains to be seen whether incumbent transmission-owning utilities will decide to take the bait. I hope that they accept our challenge to disaggregate and give up the advantages of vertical integration between their generation function, which is their biggest investment and the one most subject to competition, and their transmission function, which is the network over which that competition can reach their customers. If the network of wires can be operated independent of competing market participants, we will be well on our way to competition. RTOs, to be blunt, are very important for gas. They are good, and may prove critical, for reliability.

But, the success of our initiative will not be evident for months, perhaps years. And if voluntarism

does not work, other options will need to be explored. Yet, Congress could help competition emerge now. It has had market regionalization on its radar screen for a decade. It signaled its desire to move toward transmission access and competition as long ago as 1978 and more clearly in 1992. Since then, 24 states have opted for retail competition. But those programs will most certainly fail to deliver consumer benefits without a vibrant wholesale market. So, in the absence of any new directives from Congress, the Commission really has no choice but to undertake to open the wholesale marketplace itself. How these markets evolve is a matter of great national importance. Electricity is ubiquitous and the electric power industry is this Nation's most capital intensive. Personally, I would find it remarkable if the Congress failed to help direct its evolution, resolve the vexing state-federal jurisdictional issues that restructuring entails, and

fit this last major piece into the energy supply puzzle.

The most startling piece of the current debate is the possibility of declining reliability. A rash of brownouts or outages would almost surely replace gasoline prices on the front pages of the Nation's newspapers. Yet, that is precisely what we may be inviting. A combination of events can always conspire to produce a local outage or a regional price spike. But the challenges associated with increased competition, growing demand, surging numbers of wholesale transactions, transmission congestion, and new market entrants are more sweeping in their significance and the problems potentially far more severe. In regions of the country where generation is inadequate, large amounts of power must be imported long distances over a transmission system that is

congested and often in need of major expansion. Even the most tradition-bound incumbent public utilities recognize the impending seriousness of the problem. What I also hope they recognize is that only workable and transparent regional markets can save the day.

These factors argue strongly for a new system, one that has teeth, is democratic and transparent, engenders trust in the market, and governs the application of all standards fairly. Reliability at the wholesale level must be reestablished on a new foundation, where standards are uniform, and enforceable and the market cannot be gamed for commercial advantage. In fact, almost everyone agrees on this.

What is to be done? Power markets are made; they don't just happen. Moreover, they cannot mature overnight. The Congress, even if it acted today on some pretty good reliability legislation before it, would be unable to head off whatever problems might arise this summer. And the FERC? Believe it or not, we have no express responsibility for the reliability of the bulk power system. In the past two years, however, we have been drawn into the area by the industry, which is struggling on its own to meet the challenge of setting standards and enforcing them and has now begun to fear it will not be able to do so without our help.

Clearly, if the Commission is called upon to respond to this critical need on a national basis, it will have to choose either to beg off or to act rather boldly construing its obligation to protect the public

from the threat of declining reliability. We are likely to be asked to help institute a new national system for reliability based on private contract, instead of statutory standard setting and enforcement powers, as we have already done in the West.

Nevertheless, the stakes associated with such a strategy are high and I do not believe the Congress can simply look on. I fear that, if the electric system is perceived to be at risk by American consumers, the movement toward competition will languish or be reversed. That would be a defeat for competition and an unfortunate detour from the 21st Century energy markets that are now within our reach.

V.

High prices at the pump may serve to heighten the appreciation of the Congress and the public for the importance of sound energy policies. I must leave it

for others to address that issue, although one could argue productively about whether those prices are the result of legitimate market forces, market manipulation, or market dysfunction. I simply take comfort in the fact I do not own an SUV. However, the energy issues that have not hit the front pages or insinuated themselves into campaign rhetoric -- markets and reliability -- will prove more important even if less newsworthy, I think. We need to work together to ensure that these new energy markets are competitive, fair, efficient, and transparent. They have no precedents in the history of our energy economy. At the same time, we need to work together to keep energy services high in quality. Like prices at the pump, keeping the lights on is the way every man tests successful energy policies. I cannot tell you not to worry. I can tell you that federal and state policymakers and the electric industry must recognize

that our only option is to push ahead swiftly in completing the reinvention of the electricity marketplace.

As with all aspects of economic policy and national security, the right answers will require vision, drive, and long-term solutions. I know the Energy Council will be important to finding those answers.

Thank you.